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In The
SUPREME COURT OF THE UNITED STATES
October Term, 1997

CATERPILLAR INC.,
Petitioner,

v.

COMMISSIONER OF REVENUE,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Minnesota

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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10pp

TABLE OF CONTENTS

Page

I. RESPONDENT'S ATTEMPT TO SHIFT THE FOCUS. 1

II. THE MINNESOTA SUPREME COURT'S ERRONEOUS TEST. 5

CONCLUSION 7

TABLE OF AUTHORITIES

Page

Cases:

Associated Industries of Missouri v. *Lohman*, 511 U.S. 641 (1994) 3,4

Kraft General Foods, Inc. v. *Iowa Dept. of Rev. and Fin.*, 505 U.S. 71 (1992) 2,5

Westinghouse Elec. Corp. v. *Tully*, 466 U.S. 388 (1984) 4

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PETITIONER'S REPLY TO BRIEF IN OPPOSITION

I. RESPONDENT'S ATTEMPT TO SHIFT THE FOCUS.

Respondent effectively concedes that petitioner has established the requisite discrimination against foreign commerce under petitioner's view of the law:

> Petitioner correctly notes that a parent corporation's apportionment percentage is lower when the parent has a domestic subsidiary than when it has a foreign subsidiary. However, Petitioner's analysis is

> incomplete and incorrect because Petitioner only applies these percentages to the amount of any royalties and interest received from the subsidiaries.

Resp. Br. Opp. 10. Petitioner believes that an application of the apportionment percentages to the royalties and interest in question is all that is required to establish the discrimination against foreign commerce.

Notwithstanding the effective concession, respondent offers several reasons why the instant case is not a proper subject for review by this Court. In essence, those reasons rely heavily on respondent's interpretation of this Court's statement in *Kraft General Foods, Inc.* v. *Iowa Dept. of Fin. and Rev.*, 505 U.S. 71, 80 (1992), that in considering whether a particular statutory provision discriminates against foreign commerce, it is necessary to consider the operation of "other provisions" of the same statute.

But respondent's interpretation is very different from what this Court intended. Under respondent's view, in order to determine whether Minnesota's taxing scheme is discriminatory, it is appropriate to determine whether the *overall* Minnesota tax burden on a parent with a domestic subsidiary might sometimes be greater than the *overall* burden on a parent with a foreign subsidiary. If so, respondent argues, it cannot be said that the State taxing scheme discriminates against foreign commerce in its treatment of interest and royalties.

There is no basis for respondent's contention. The discrimination inherent in Minnesota's tax treatment of interest and royalties that are received from unitary foreign

subsidiaries cannot be mitigated by reference to the overall tax burden on the "water's edge" group attributable to other, unrelated business activity.

It is well-settled that a State may not discriminate under any portion of its taxing scheme, even if the taxpayer being discriminated against could enjoy unrelated benefits under other provisions of the same scheme. This principle was recently reaffirmed in *Associated Industries of Missouri* v. *Lohman*, 511 U.S. 641 (1994). In that case, this Court rejected the State's contention that a use tax on goods purchased out of state, which discriminated against interstate commerce in those localities where it was higher than the locally imposed sales tax, nevertheless passed constitutional muster because the "overall impact of the use tax" showed equivalency with the local sales tax burden when calculated on a statewide basis. (511 U.S. at 649.)

> Respondent's theory assumes that discrimination in some parts of a state tax system may be permissible under the Commerce Clause as long as it is of a sufficiently limited magnitude to be offset by preferential treatment for interstate trade in other portions of the tax scheme. * * *
>
> We have never suggested, however, that patent discrimination in part of the operation of a tax scheme...can be rendered inconsequential for Commerce Clause purposes by advantages given to interstate commerce in other facets of a tax plan....

Id.

While *Associated Industries* involved transaction taxes, the principle which it enunciated is equally relevant in the context of a State income tax. That point was made clear in *Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388 (1984), which involved New York's franchise tax on corporate income:

> The tax schemes rejected by this Court in both *Maryland* v. *Louisiana* and *Boston Stock Exchange* involved transactional taxes rather than taxes on general income. That distinction, however, is irrelevant to our analysis. The franchise tax is a tax on the income of a business from its aggregated business transactions. It cannot be that a State can circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate--as is the franchise tax--rather than on individual transactions.

466 U.S. at 404.

If the position advanced by respondent here were the law, this Court's decision in *Westinghouse Elec. Corp.* would be seriously flawed. No inquiry was made in that case regarding the overall burden on the taxpayer under the New York franchise tax scheme. Rather, this Court reviewed the operation of the New York tax credit allowed for export activity emanating from within the State and determined that the granting of the credit impermissibly discriminated against interstate commerce. In reaching its decision, this Court compared the actual New York tax burden on three

hypothetical corporations carrying on varying amounts of export activity in the State but otherwise similarly situated. There was no focus on the overall tax burden that might be imposed on each corporation depending on variations in other aspects of its business activity. Rather, the sole focus was on the tax burden imposed on income derived from export activity.

Similarly, in *Kraft*, this Court first determined the proper basis for comparison in testing the claim of discrimination. It then focused on the unfavorable tax treatment of the foreign subsidiary dividends in the context of that comparison. It did not undertake to consider the overall tax burden on each parent company under Iowa's taxing scheme. Respondent's emphasis on overall tax burdens under Minnesota's taxing scheme completely misses the point.

II. THE MINNESOTA SUPREME COURT'S ERRONEOUS TEST.

Notwithstanding respondent's claim to the contrary, the fact is that the Minnesota Supreme Court adopted a new test for determining whether a state's taxing scheme is discriminatory. That is clear from the following statement in the court's opinion:

> Furthermore, on the record before us, Caterpillar has failed to meet its burden of showing an undue burden on foreign commerce in this case. *See Hughes*, 441 U.S. at 336. Caterpillar has not shown the difference, if any, between the Minnesota corporate excise tax that would be paid under the water's edge combined method and the corporate excise tax that would be paid if

> Caterpillar's foreign members were treated similarly to its domestic counterparts.

Pet. App. 15a. No decision of this Court has ever required that a claim of discrimination be proven by reference to how the taxpayer would fare under a different system of taxation not adopted by the taxing state. Yet, that is precisely what the Minnesota Supreme Court held was required of petitioner.

This Court has not previously reviewed a case involving "water's edge combined reporting." In petitioner's view, certiorari is necessary because the court below misapplied the law and adopted a test for showing discrimination that is inconsistent with this Court's prior decisions in this area. At a minimum, the uncertainty regarding the proper test to be applied demonstrates the need for guidance from this Court with respect to the scope and limits of the "water's edge" method of taxation.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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